CAPITAL PLANNING ADVISORY BOARD

Minutes of the 3rd Meeting of the 2005 Calendar Year

August 26, 2005

The 3rd meeting of the Capital Planning Advisory Board (CPAB) of the 2005 calendar year was held on Friday, August 26, 2005, at 10:00 AM, in Room 327 of the Capitol. Senator Jack Westwood, Chair, called the meeting to order, and the secretary called the roll.

Present were:

<u>Members:</u> Senator Jack Westwood, Co-Chair; Representative Perry Clark, Co-Chair; Senator David Boswell, Paul Gannoe, Bill Hintze, William May, Norma Northern, Laurel True, Garlan Vanhook, Judge William Wehr, and Melinda Wheeler.

<u>Guests Appearing Before the Board:</u> Sherron Jackson, Assistant Vice President for Finance, Council on Postsecondary Education; and Mike Inman, Commissioner, Commonwealth Office of Technology.

<u>LRC Staff:</u> Pat Ingram, Mary Lynn Collins, Nancy Osborne, Mike Clark, Kristi Culpepper, and Debbie Rodgers.

Noting that Bill Hintze, who has served on the Board since it was established in 1990, is retiring from state government at the end of August, Senator Westwood asked Mr. Hintze if he would like to take a few minutes and reflect on his service on the Board.

Mr. Hintze said he and Mr. True are the remaining original members of the Board. He was named by then-Governor Wilkinson as an Executive Branch appointee, and Mr. True was a Legislative Branch appointee. He said when the Board was created it was innovative in being the first attempt to take a broad-based, long-range view of capital needs and priorities in the state. Its most unique feature is the involvement of all three branches of government with almost equal representation. Mr. Hintze said that has been as important and strong a factor in the credibility of the Board's work as any other single thing. There is not another Board like it in the state, or possibly in the nation.

Mr. Hintze said *Governing* magazine, which conducts periodic reviews of the quality of governance in the states, has consistently given Kentucky high scores relative to capital planning and capital management in part because of the creation, continuation, and membership of CPAB. He said he hopes everyone will realize that the Board is

recognized nationally, and many states would like to emulate what Kentucky has already done.

Noting the transformation of the court facilities in the last 10-11 years, Mr. Hintze said that has occurred in part through the efforts of the Board and its providing an opportunity for the needs of the Judicial Branch to be presented in an objective setting. He said the Board allows for a much more thorough and deliberate review of capital needs than is often afforded to state agencies during a legislative session.

Other events cited by Mr. Hintze since the creation of the Board include the increasing importance and size of information technology needs in the plan submissions, the rejuvenation of the state park system, and an increasing volume and range of state capital investments. While these are not all a result of the Board's activities, he said the Board should share in the credit for the accomplishments that have occurred in the capital area.

Mr. Hintze also complemented CPAB staff, past and present, for the work they do in reviewing a large volume of materials, condensing it, and putting it in context for the Board to consider. He encouraged others to review the materials provided to the Board in order to become better informed about the state's capital needs and priorities. Mr. Hintze concluded by saying he finds the work to be interesting and important, and that it has been a real pleasure to serve on the Board. He added that it is possible he will continue serving on the Board as the Executive Branch's citizen member appointee.

Senator Westwood said he appreciated the historical perspective that Mr. Hintze had provided in his remarks, then asked CPAB Staff Administrator Pat Ingram to read aloud a resolution honoring Mr. Hintze. Mr. True's motion to approve the resolution was seconded by Senator Boswell and approved by unanimous voice vote.

After commending Mr. Hintze on his service to the Commonwealth, Senator Boswell said he hoped Mr. Hintze would continue to speak out on issues important to the state. Representative Clark said it is always said that everyone can be replaced, but he is not sure that is the case in this instance.

Senator Westwood noted that there were two sets of minutes needing Board action. Senator Boswell's motion to approve the minutes of the July 12-13 meeting was seconded by Mr. Hintze and approved by voice vote. Senator Boswell then made a motion to approve the minutes of the August 11 meeting. That motion was also seconded by Mr. Hintze and approved by voice vote.

Senator Westwood next asked Ms. Ingram to review the information items included in the members' folders. Ms. Ingram said the first item was a list of construction project recommendations submitted by the Council on Postsecondary Education (CPE)

based on the new model that CPE President Tom Layzell had described at the July meeting.

The second item was background information on the matching pools for maintenance that were appropriated for the institutions in the 1998-2000 and 2000-2002 budgets. Representative Clark expressed concern about issuing bonds to fund maintenance and said he hoped whatever projects are undertaken with such funds have a life cycle that is longer than the term of the bonds.

Ms. Ingram said the next information item explained that the increased cost for Murray State University's proposed Breathitt Veterinary Center replacement in Hopkinsville was due to a combination of factors including an update of estimates initially prepared in the mid 1990s and the cost of constructing part of the Center as a bio-safety level 3 facility.

The next item addressed the Community Economic Growth Grant program administered by the Governor's Office for Local Development (GOLD). Ms. Ingram said GOLD has determined that "retirement of a mortgage or other indebtedness on a capital project made within the preceding five calendar years" as discussed at the last CPAB meeting should not be included in the list of eligibility criteria, and program manuals will be changed accordingly. Senator Westwood asked if that change would effect already-submitted applications or not go into effect until the manual is updated. Dan Waits, of GOLD, said he was unsure and would follow up with Senator Westwood.

Ms. Ingram said the fourth agenda item provided additional descriptive information that had been requested about the Purchase of Agriculture Conservation Easements (PACE) program.

The next item addressed questions about school facilities maintenance that had been raised at the last meeting. It noted that the study being done by the Office of Education Accountability will include the collection and analysis of data on school maintenance.

The seventh information item provided confirmation from the Kentucky Infrastructure Authority to its response at the August 11 meeting that amounts from Fund B (Infrastructure Revolving Loan Program) could be used for work on the Kentucky River dams or to construct a pipeline to address water supply issues.

The final information item was the report of the CPE's review of the information technology projects submitted by the postsecondary institutions and included a list of 15 "high value" projects. It also noted that the CPE will propose bond financing for upgrades of campus administrative and instructional systems.

Senator Westwood said that as part of the review of the agency plans and development of the statewide plan, it has been the Board's practice to receive a report on the Commonwealth's debt position from the staff of the LRC Economist's Office. He introduced Mike Clark and Kristi Culpepper to make that presentation. Mr. Clark said the presentation would be based on a memo included in the members' folders, which discusses trends related to debt indicators and issues that rating agencies consider when evaluating state debt.

Ms. Culpepper said decisions about issuing debt need to be based on a cost benefit analysis. Policy makers must consider the benefits of providing for essential government services, funding state programs, and maintaining or improving state facilities and infrastructure and the costs associated with these policies. If they are funded by issuing debt, the interest paid on the debt contributes to the total cost such that the cost of the debt and the factors that affect the cost of debt can impact policy decisions.

Ms. Culpepper said factors determining the cost of debt are the perceived risk of default, the overall financial situation of the state, the amount of debt outstanding, the nature of the state's economy and its growth and stability, and the opinions of the credit rating agencies.

Ms. Culpepper said the rating agencies consider financial management the most important dimension of a state's debt and discussed the importance rating agencies place on having a structurally balanced budget and on having a budget reserve fund. She then reviewed a chart showing the historic and projected balances in Kentucky's Budget Reserve Trust Fund since 1990.

Ms. Culpepper next reviewed charts showing Kentucky's debt levels including projected FY 2005/06 debt outstanding (\$5.74 billion) and the new debt authorized in the 2004-06 budget (\$1.9 billion). She noted that the state's debt outstanding has been trending upward. In presenting figures from Moody's Investors Service showing net tax supported debt per capita and net tax supported debt as a percent of personal income, she noted that the rating agencies cite these as their primary debt indicators because they show how much the state has extended its tax base. Kentucky is higher on these two measures than most other states.

Ms. Culpepper then addressed economic factors for Kentucky including the tax base (employment and personal income), economic diversity which relates to the susceptibility to economic downturns, and demographics (including Medicaid trends which may affect the budget).

Relative to the credit rating agencies' outlook for the Kentucky's debt, Ms. Culpepper said the agencies have cited three main concerns - the trend of late budget adoption, past budgets not being structurally balanced, and the state's slow economic

growth relative to national trends. She concluded by listing three avenues of communicating the willingness and ability to pay off debt. They are maintaining a structurally-balanced budget, funding the budget reserve trust fund, and keeping the debt indicators within the rating agencies' parameters.

Senator Boswell thanked Ms. Culpepper for an informative presentation. He said the tax modernization was a good start but that more comprehensive tax reform and additional revenues are needed - and gaming might provide that opportunity. He also expressed concerns about the state issuing bonds for local projects such as equipment purchases, which have a life cycle shorter than the term of the bonds.

In response to Senator Westwood's question about whether the market would consider that gaming provides a stable source of revenues, Mr. Clark said gaming would provide additional revenue and the market would look at how that revenue was being used in determining the effect on interest rates.

Responding to a question from Representative Clark about why the market would have concerns about having a high percentage of employment in manufacturing, Ms. Culpepper said the concern is not about a particular segment of the economy rather there is a desire to have a diverse tax base to provide for revenue stability since economic downturns tend to affect one sector more than the others.

Relative to Medicaid costs, Senator Westwood asked whether Kentucky was in a worse position than other states. Ms. Culpepper said a National Association of State Budget Officers survey reported that 20 states have experienced budget shortfalls in this area, but that Medicaid differs substantially from state to state. Senator Boswell noted that Kentucky has a more unhealthy population, which has an impact on Medicaid costs, and that certain Medicaid costs are allowed in some states and not in others.

Mr. Hintze said this report had addressed a lot of important information and issues and he hopes the dialogue continues relative to not only the capital projects issues, but also the various competing demands and factors that comprise the state budget and the state's economy. He said while Kentucky maintained its credit rating following the 2005 session, the state continues to be watched closely by the rating agencies relative to how the factors cited in the report will be addressed including maintenance of an adequate Budget Reserve Trust Fund (BRTF). He also noted that the \$90 million being put into the BRTF from the end of FY 2004/05 surplus is the maximum allowed by the enacted 2004-2006 budget.

Representative Clark noted that in the late 1980s a task force studied the state's issuance of bonds and bonded indebtedness. He said it might be appropriate for the Board to recommend that another such task force be established. He said that potential policy recommendation would be included on the agenda for the next meeting.

In response to questions from Senator Boswell, Mr. Hintze said the \$100 million bond issue for renovations at the Kentucky State Parks had been authorized by the 1994 Special Session and that the 2005 Session authorized \$35 million in state bonds for additional facility upgrades. He also noted that in the intervening 10 years, substantial authorizations had been provided for new golf courses at some of the parks.

Senator Westwood said the Board would next discuss potential policy recommendations to be included in the 2006-2012 Statewide Capital Improvements Plan, with project recommendations to be addressed at the next meeting. He said after Ms. Ingram reviews each recommendation, the Board needs to provide some direction to staff on how to proceed.

The first recommendation presented by Ms. Ingram addressed project thresholds. She explained that the dollar levels at which projects must be submitted through the capital planning and budgeting process have not been changed since 1994 and that the need to raise those amounts was noted several times during the July CPAB meeting. The current levels are: construction - \$400,000; information technology systems - \$400,000; and equipment - \$100,000. Ms Ingram presented the following potential recommendation: That KRS 7A.020(10) and KRS 45.750(1)(f) be amended by the 2006 General Assembly to change the thresholds for submitting projects in the capital planning and capital budgeting processes to the following: construction - \$600,000; information technology systems - \$600,000, and equipment - \$200,000.

Ms. Northern said she agrees that the thresholds need to be raised. Mr. Vanhook asked about projects needing funding that do not reach these levels. Mr. Hintze said those projects can be included in a project pool in the capital budget, or financed from the operating budget. He also noted that these are modest increases in the thresholds and that the other significant factor is at what level the General Assembly wants to exercise its review of projects. Staff is to finalize the recommendation as presented.

The next item addressed limits for "force accounts," which allow agencies to undertake projects using in-house labor without going through the state's competitive bid process. Ms. Ingram said the current limits are \$100,000 for projects of the postsecondary institutions and \$200,000 for projects of other state agencies. At the July meeting, some of the postsecondary institutions requested that their force account limit be increased. Ms. Ingram presented the following proposed recommendation: That the 2006 General Assembly amend KRS 164.585(40) to permit postsecondary institutions to use in-house labor for any construction projects with a total cost of up to \$200,000. Staff is to finalize the recommendation as presented.

Ms. Ingram said the next potential recommendations deal with maintenance of state facilities and have been included in previous plans. The first related to setting aside

funds to deal with major capital renewal and maintenance (projects costing \$400,000 or more each) for existing buildings. Ms. Ingram noted that the Finance and Administration Cabinet is now working with the postsecondary institutions to develop a proposal that will address their concerns about previously-introduced legislation in this regard. She presented the following proposed recommendation: That legislation be enacted by the 2006 General Assembly to establish an approach for financing the major capital renewal and maintenance needs of state facilities.

Kristin Webb, from the Office of the Secretary of the Finance and Administration Cabinet, confirmed that the Cabinet is working with the institutions, but they have not yet finalized language to be included in proposed legislation for the 2006 Session. Mr. Hintze said he continues to support this recommendation. Senator Westwood said there is a need to take care of state facilities, and he hopes the Board agrees with this recommendation. Staff is to finalize the recommendation as presented.

Ms. Ingram said the fourth potential recommendation deals with the pools that are appropriated to agencies for smaller projects (costing less than \$400,000 each) and states the following: That adequate and equitable funding be provided for the agency maintenance pools, and to accomplish that, the following actions should be taken: 1) each agency with responsibility for administering/managing state-owned facilities should be appropriated funding for a maintenance pool in the biennial executive branch budget; 2) funding recommended for agency maintenance pools should be calculated in an equitable manner across all agencies, with an appropriate offset to the calculated need for state funds for those agencies with restricted or facility-generated funds that are available for this purpose; 3) the Governor's Office for Policy and Management and the Department for Facilities and Support Services should develop a formula for maintenance pool funding that takes into account relevant factors such as square footage, age, and condition of facilities. This effort should be completed no later than July 2007, and quarterly progress reports should be made to the Capital Planning Advisory Board beginning in July 2006; and 4) when Investment Income revenues are insufficient to adequately finance the agency maintenance pools, the state General Fund or other appropriate revenues should be used.

Mr. Hintze said there has been an effort to extend the maintenance pools to agencies that need them, but the adequacy of funding for the pools is an issue. He explained that while the previous recommendation addressed major maintenance for new facilities, these pools provide funding for lower levels of maintenance of existing buildings that can help alleviate the need for larger maintenance expenditures in the future. Mr. True expressed his concern about a lack of good supervision and maintenance at facilities such as the parks. Staff is to finalize the recommendation as presented.

The next potential recommendation presented by Ms. Ingram addressed the Finance and Administration Cabinet's statewide implementation of the real

properties/facilities management database. She presented the following recommendation: That the Finance and Administration Cabinet work with appropriate executive branch agencies (including the Commonwealth Office of Technology) and the postsecondary institutions to develop a plan for statewide implementation of the database as mandated by KRS 42.027. Written reports on development of the plan and implementation of the database should be submitted to the CPAB at least quarterly, beginning in January 2006. Also proposed as part of the recommendation was that appropriate funding and personnel levels required to expedite implementation of the real properties/facilities management database be identified and provided. Staff was directed to finalize the recommendation as presented.

The subject of the next potential recommendation was alternatives to incarceration. Ms. Ingram noted that comparable recommendations have been included in numerous previous plans and presented the following recommendation: That the Executive, Legislative and Judicial Branches identify and implement alternatives to incarceration and adequate treatment options (where appropriate), consistent with public safety and victims' rights, that could reduce the prison population growth and the attendant need for the construction of new facilities.

Senator Boswell said this was an excellent recommendation. Judge Wehr said he also agrees with the recommendation, but it is somewhat generic and he would like for it to recommend increased funding for programs that have documented savings and have proven to be appropriate alternatives to incarceration. As specific examples, he cited the drug court programs and the community corrections program. Senator Westwood noted that there are also various successful faith-based programs. Mr. True also expressed support for making a stronger recommendation and asked that additional information be obtained from the Cabinet for Health and Family Services. He suggested asking the Governor to assemble a task force to develop proposals for alternatives. Representative Clark also expressed support for strengthening the recommendation. Judge Wehr noted that in addition to alternatives, there is a need for treatment for those who must be incarcerated. Staff was directed to work on revising the recommendation to be more specific.

Ms. Ingram explained that the next two items did not include specific proposed recommendations, but seek further direction as to how the Board wants to handle recommendations contained in the reports submitted by the Council on Postsecondary Education (CPE) and the Commonwealth Office of Technology (COT).

Ms. Ingram said the CPE report had recommended that the Board continue its efforts to establish a recurring system that will generate sufficient funds to address long-term maintenance of state facilities. She said this has been addressed by the Board's earlier consideration of the recommendation for establishing a mechanism for funding major maintenance. The CPE report had also recommended identifying ways to allow

institutions to address non-education and general space needs outside of the traditional state bonding authority. Ms. Ingram said this recommendation relates to legislation that has been proposed to allow institutions to issue auxiliary enterprise bonds and for auxiliary enterprise debt and revenues not to be considered in the calculation of the state's debt capacity.

In response to a question from Senator Westwood about how this legislation might impact the state's bond rating, Ms. Culpepper said the rating agency analyst she contacted did not have a direct answer in that regard. Mr. Clark indicated that while the state may not have a legal liability for the debt, there may be a practical obligation that requires the university to support the debt if necessary.

Mr. Hintze said this is an important and complicated issue that is not readily susceptible to a resolution by the Board without much more study. He noted Chairman Clark's call earlier in the meeting for a review of various issues related to the state's debt. Noting that these issues are deserving of a public discussion involving testimony from knowledgeable individuals, he said he would welcome such a review.

In response to an invitation to comment from Senator Westwood, Sherron Jackson, CPE Assistant Vice President for Finance, said the Council is asking the Board to take some action to move toward a way to address these needs and is not necessarily asking for an endorsement of specific legislation that has been proposed. He said he would support the establishment of a group to study the issue.

Senator Westwood asked staff to incorporate this issue in its draft recommendation for a state debt study, which will be considered at the next CPAB meeting.

Ms. Ingram said the final policy recommendations to be considered were those included in the report from the Commonwealth Office of Technology (COT). One of the four items - regarding project thresholds - has already been addressed. The other three related to information technology (IT) consolidation, the establishment of a maintenance pool for agency information technology upgrades and replacements, and project management practices. Ms. Ingram said that because his presentation on July 13 had focused on project recommendations rather than these policy issues, COT Commissioner Inman had been invited to meet with the Board again at this meeting to further address these items.

Regarding the recommendation on IT consolidation, Commissioner Inman said the request is for the Board to support the concept as it is included in Executive Order 2005-562 signed by the Governor on June 16. He said the focus is on infrastructure but consolidation would be done wherever it makes sense. He said the intent is to reduce

redundancy and waste in order to reduce the cost and increase the level of services provided to the state.

Regarding the recommendation on pool funding for IT infrastructure, Commissioner Inman said the idea is not as well developed as they would like, but the plan would be to set the service fees charged by COT to agencies at a level to address the life cycle of the application or system, not just the development costs. This would allow for ongoing refreshes of hardware and continued support of applications. In response to a question from Senator Westwood, Commissioner Inman said it is expected that efficiencies from consolidations would allow the maintenance cost to be absorbed into existing charges.

Regarding the recommendation on project management practices, Commissioner Inman said KRS 11.507(h) already charges COT with the responsibility of reviewing and overseeing large or complex information technology projects and systems for compliance with statewide strategies, policies, and standards including alignment with the Commonwealth's business goals, investment, and other risk management policies. He said he is asking for the Board to express its support for COT moving in this direction, and perhaps to recommend even more directive language in this regard. He said he believes the language is somewhat ambiguous and there has not been an expectation in the past that COT would enforce it; however, they now intend to do so.

Commissioner Inman summarized by saying he is seeking support from the Board for these recommendations relative to the direction COT is moving with IT in the state.

Mr. Hintze said the State Budget Office has had discussions with Commissioner Inman about the financial implications of the approach being taken, but he does believe these recommendations are consistent with the direction the Board has taken in the past. He said while there have been significant increases in IT investments, there will not be major increases in funding to sustain those operations so there is a need to use the money currently available with only incremental adjustments.

In response to a question from Ms. Northern, Commissioner Inman said the consolidations would focus on infrastructure such as internet, email, and telephone service. He said there is also the potential for significant savings in business applications, but that would come from implementing a project management approach more so than from consolidation. One example he suggested was for COT to have cooperative agreements so that COT could use developers from other state agencies when there is a work overload rather than hiring additional personnel, or contracting out the work.

CPAB staff was directed to draft a policy recommendation based on the discussion of the COT recommendations.

Senator Westwood noted that the next meeting, originally planned for September 16, would need to be changed due to scheduling conflicts. Staff will inform members when the new date is determined.

There being no further business, the meeting was adjourned at 12:28 p.m. in honor of William H. Hintze, Jr.